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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

10 March 1983

China: Prospects for Use of Foreign Loans [redacted] 25X1

Summary

China's recently announced plans to increase imports by some 40 percent in 1983 and to undertake extensive industrial development projects over the next several years have attracted considerable attention among international bankers eager to supply credit. The Five-Year Plan, however, projects only minor trade deficits through 1985 and China is likely to borrow only modestly from commercial bank for normal short-term trade financing. Capital goods imports will be financed largely from current account earnings, but Beijing will also continue to press for concessionary loans from Japan and various international organizations. If China is unable to meet its credit requirements through these sources, its extensive foreign exchange reserves can also be tapped. Beijing is more likely to scale back its spending plans than to borrow large amounts at high commercial interest rates. [redacted] 25X1

The Plan and China's Current Foreign Exchange Position

Over the past two years, while most LDCs have been in the throes of major financial problems, the Chinese have been using large trade surpluses to retire debt ahead of schedule. By yearend 1982 total debt outstanding probably declined to $3.7 billion giving China one of the lowest debt-service ratios of any LDC at about 7 percent. Even after stepping up its loan repayments, Beijing's foreign exchange reserves have continued to mount. At present, reserves probably exceed $10 billion, equivalent to more than seven month's imports. When China's gold

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holdings are factored in--about $6 billion at current prices--China occupies one of the strongest international financial positions of any LDC, a position from which a major surge in imports can be expected. 25X1

Western exporters of industrial raw materials, equipment and technology stand to be the major benefactors of China's 1983 import drive. Beijing is emphasizing energy and infrastructure projects as well as heavy industry. Over the period of the Five Year Plan (1981-1985) we expect capital goods imports to exceed $40 billion--twice the level brought in during the previous five-year period. This is likely, despite the fact that an economic retrenchment program instituted in 1979 cut sharply into capital purchases during the first two years of the plan. 25X1

<u>Additional Financing Requirements--Minimal</u>

The surge in imports should create no financial problems for Beijing. The 1983 increase will bring imports back in line with the five year plan; the 9.2 percent average annual growth rate targeted under the plan has been undermined by consecutive declines in imports in the past two years. Assuming that Beijing is able to achieve its modest export growth targets of 8.1 percent between 1981 and 1985, trade will be in near balance in 1983, in slight deficit by 1984 and only about $1 billion in the red by 1985. 25X1

With most of its import purchases financed by export revenues, Beijing will have little need for foreign credits. Nevertheless, we expect the Chinese to continue to push for available long-term, low-interest loans. Japan's Overseas Economic Cooperation Fund (OECF) has already been asked to provide $5-6 billion in aid credits in addition to the $1.5 billion approved in 1979. The loans are intended to cover 12 infrastructure and mining projects that Beijing has earmarked as essential to China's development. The Chinese can probably afford to finance the import costs of these projects out of foreign exchange holdings. By borrowing the funds at 3-5 percent, however, the Bank of China frees up funds which it can then lend at near commercial rates. 25X1

Over the next three years, Beijing will also draw approximately $600 million that the World Bank has already agreed to lend and will probably line up an additional $1-2 billion in Bank credits. By 1985 the Chinese will have drawn all of the $2 billion in Exim resource development loans offered by Japan. Aid and Exim credit drawdowns from Western Europe will probably amount to less than $1 billion through 1985. 25X1

The Chinese have used commercial credits for normal trade financing in the past and will continue to do so in the future. These short-term funds are constantly being rolled over and will not constitute a major portion of outstanding debt. 25X1

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With several financially troubled LDCs competing for Japanese aid, Beijing probably believes it has little chance of obtaining recently requested OECF loans unless it can demonstrate sincere concern for a deterioration in its own future financial position [redacted] 25X1

Remaining Uncertainties--Exports and Energy

Although China believes it has carefully planned its financial future under the five-year plan, there are two major uncertainties that could necessitate additional borrowing. Beijing has projected a modest 2 percent real growth in exports in 1983 but must achieve a respectable 11 percent rate in 1984 and 1985 to meet the plan. For every 1 percent shortfall in export growth, Beijing will add approximately $200 million to its deficit in 1984 and $500 million in 1985. If exports climb at only 5 percent in 1984 and 1985 for example, while imports expand at the expected 13 percent rate, the annual trade deficits would amount to $1.7 billion and $3.8 billion respectively. [redacted] 25X1

A poor performance by the energy sector may create future strains on Chinese foreign exchange. Oil export earnings, which currently contribute 15 percent of China's total foreign exchange revenues, may fall off sharply as oil prices decline and domestic onshore oilfields are depleted. Offshore exploration will not require Chinese foreign exchange outlays. However, development of offshore fields may require as much as $2 billion over the next three years, and much larger sums by the late 1980s. Other major energy-related projects such as hydropower, coal, and large nuclear reactors that, at present, are only in the negotiating stages could tack billions of dollars onto China's import bill. Beijing's current efforts to retain a strong international financial posture may be directed at such future costs. [redacted] 25X1

Although it is not clear that Chinese economic planners are aware of the potential effect of uncertainties on their targeted trade figures, they have stated a willingness to acquire larger debt burdens if necessary. They have indicated that a debt-service ratio as high as 15 percent may be acceptable, raising the possibility that China is prepared to borrow up to $15 billion over the next three years. Although there would be no difficulty finding willing lenders for that amount, it is highly unlikely that Beijing is ideologically prepared to undertake such a move. Chinese economic planners continue to adhere to conservative international borrowing policies. We believe they would elect to curtail imports rather than allow their debt-service ratio to exceed 10 percent or foreign exchange reserves to fall below 4-5 months imports over the next three years. [redacted] 25X1

China's Trade Plan 1981-85
(Billion US $)

	Exports (f.o.b.)	Imports (f.o.b.)	BAL
1981 1/	21.4	18.0	3.4
1982 2/	21.6	15.6	5.7
1983 3/	22.0	22.0	0
1984 3/	24.4	24.8	-0.4
1985 2/	27.0	28.0	-1.0

1/ CIA
2/ MFERT
3/ Straight Line Projections to 1985 Targets (11% for exports, 13% for imports)

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